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LMRK - Q3 2018 Landmark Infrastructure Partners LP Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Landmark Infrastructure Partners' Third Quarter 2018 Earnings Conference Call. (Operator Instructions) And as a reminder, this conference call is being recorded for replay purposes.

I would now like to turn the conference over to Mr. Marcelo Choi, Vice President of Investor Relations. Please go ahead.

Marcelo Choi - *Landmark Infrastructure Partners LP - VP, IR*

Thank you and good morning. We'd like to welcome you to Landmark Infrastructure Partners' third quarter earnings call. Today, we'll share an operating and financial overview of the business and we'll also take your questions following our presentation. Presenting on the call today are Tim Brazy, Chief Executive Officer, and George Doyle, Chief Financial Officer.

I would like to remind all participants that our comments today will include forward-looking statements, which are subject to certain risks and uncertainties. A number of factors and uncertainties could cause actual results in future periods to differ materially from our current expectations. For a complete discussion of these risks, we encourage you to read the Partnership's earnings release and documents on file with the SEC. Additionally, we may refer to non-GAAP measures such as FFO, AFFO, EBITDA, adjusted EBITDA, and distributable cash flow during the call. Please refer to the earnings release and the public filings for definitions and reconciliations of these non-GAAP measures to their most comparable GAAP measures.

And with that, I'll turn the call over to Tim.

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Marcelo, thank you. As you've seen from our various announcements, the third quarter was an extremely busy quarter for us. Today, we're going to talk about our third quarter results and provide you with an update on our operating and financing activities as well as our strategic initiatives, including the Brookfield joint venture and FlexGrid developments. In the third quarter, we realized another quarter of strong operating performance and financial results. Rental revenue grew 30% year-over-year, led by the acquisitions we completed in the last 12 months and the strong growth profile of the assets in our existing portfolio.

Our assets continue to perform well and the portfolio continues to deliver stable and growing cash flows from the combination of growth from contractual lease escalators, lease modifications, and renewals, and the low churn of our assets. In terms of acquisitions, year-to-date through

September 30, we've acquired 217 assets for total consideration of approximately $135 million. Those assets are expected to contribute $10.2 million in annual rents and were comprised of 74 wireless communication, 136 outdoor advertising, and 7 renewable power generation assets. At our sponsor level, acquisition activity continues to be very strong, market conditions are very favorable, and we see significant ongoing opportunities to buy assets at advantageous pricing.

Overall, we are making substantial progress on a number of fronts, focusing on strategic partnerships, multiple development and deployment opportunities for FlexGrid, and continued growth in our domestic portfolio and international activities. But more importantly, we are now changing our strategy to a direct acquisition model where we buy and develop assets directly inside the partnership rather than acquiring portfolios our sponsor has assembled as we've done in the past. We believe this will result in more accretion to the partnership, while deploying less capital. When you acquire a portfolio of assets by buying them one at a time as we do, the price you pay for individual assets is less than the portfolio value of those assets. In other words, the whole is greater than the sum of the parts.

We expect those higher cap rate, direct acquisitions, and developments that have higher growth profiles will deliver greater accretion at the partnership. This is an important transition for LMRK, as we continue to grow the partnership towards our stated goal of converting to a better corporate structure, which as we've previously discussed is an internally managed REIT. With our large portfolio today and a significant pipeline of acquisitions and developments in many increasingly attractive markets, we believe we're very well positioned and should be able to consider the conversion within the next 2 to 3 years. In addition, as George will discuss later on the call. The partnership has also taken some additional steps now in preparation for this transition. For example, reporting and financial management to better align with and compare ourselves to our anticipated REIT peer group with more transparency.

Now let's talk about some of our recent developments. On prior calls, we've talked about developing new strategic relationships, including capital, operating and technology partnerships that would benefit LMRK and drive accretive growth. To that end in September, we announced our joint venture with Brookfield Asset Management, a leading global asset manager and infrastructure investor to invest in core infrastructure assets.

This joint venture is a significant milestone for Landmark because it further validates our ground lease asset class. Just like the more traditional infrastructure investments favored by institutional investors, our ground lease assets have similarly attractive investment characteristics. They are essential assets for operating businesses and future high credit quality with low volatility in correlation to traditional investment alternatives.

Our partnership with Brookfield strengthens our ability to pursue the opportunities we see in our markets and should leverage the strengths of both parties, allowing us to significantly expand our reach in our core industries. Remember this venture is a continuation of our strategy to establish significant partnerships that complement Landmark's overall business, enhancing our leadership position in infrastructure and real estate assets and further supporting our acquisition efforts and development initiatives. In the initial transaction, the partnership contributed a portfolio of 545 wireless communication assets, including the associated debt of approximately $125 million in exchange for a 50% interest in the JV and $65.5 million in cash, providing the partnership with equity at a very attractive cost of capital, essentially at NAV or net asset value. We'll use the capital from the transaction to de-lever the balance sheet and drive future acquisition and development activities. The formation of the joint venture does not represent a change in strategy for the partnership, but rather gives us additional resources to execute on our plan.

Turning to our development activity, as you've seen in our recent announcement, we've made significant progress with FlexGrid entering into an agreement with the Dallas Area Rapid Transit system, also known as DART. In October, we entered into the DART agreement to develop a smart city media and communications platform, including content-rich kiosks and our FlexGrid ecosystem solution on select high traffic locations within DART's transportation network.

We're building out the digital media infrastructure with smart city media, a leading media company which partners with cities to develop smart infrastructure solutions. Smart City Media will operate the digital kiosk platform, and the platform will feature local content, real-time information, and connectivity, while also providing digital advertising public Wi-Fi, and safety and security functions. In total, we expect to deploy more than 300 kiosks at select DART high traffic locations with initial kiosks anticipated to be installed around the end of this year.

We expect most of the installations will be completed during 2019 with revenue growing over that time. A number of wireless carriers and other groups have expressed interest in DART's footprint and we're currently in discussions with several of them about potential anchor and co-location positions for the project. The recent DART engagement illustrates wide Landmark's FlexGrid is an ideal solution as a neutral host co-location environment, it can meet the specific needs of both the property owners and the mobile network operators and other tenants, and it can support a wide variety of deployments from small cell to macro level installations. Most importantly, the FlexGrid solution is highly customizable and can be deployed quickly to meet the needs of all of the unique participants in a particular project.

In addition to DART, we continue to discuss opportunities with other strategic real estate owners within our targeted segments, including other cities, transportation authorities, and commercial real estate owners. As we said previously, the FlexGrid solution has been very well received by potential partners and tenants, the pipeline of potential opportunities continues to expand and we anticipate significant further growth in the development area.

With regard to our European efforts in outdoor advertising, the strategic partnership with our UK partner has been very successful for LMRK. And we continue to buy and develop outdoor advertising assets in Western Europe at attractive cap rates. Our billboard portfolio there continues to grow, we see a lot of acquisition and development opportunities in that market. Through September 30 of this year, LMRK has invested approximately $44 million in the UK, including about $17 million this year. As we finish up 2018 and look ahead to next year, we're excited by the tremendous progress we've made, and the opportunities that we see. With the continued strong performance of our portfolio, the favorable market conditions and the significant acquisition and FlexGrid development opportunities, we believe we're in a great position to take advantage of our large and growing markets. And with new strategic relationships, adding to our capabilities, we're very confident that we're able to execute on our business, grow the partnership and deliver long-term value for our unitholders.

And with that, I'll turn the call over to George, who will provide a more detailed financial review of the quarter. George?

George P. Doyle - *Landmark Infrastructure Partners LP - Treasurer, CFO & Principal Accounting Officer of Landmark Infrastructure Partners GP LLC*

Thank you, Tim. Before I discuss this quarter's results, I'd like to highlight our longer term goal of positioning the partnership to consider an internalization of the sponsor and converting the partnership into an internally managed REIT, which we believe is the optimal operating structure for Landmark Infrastructure. In 2017, we started that process by completing the legal structure change by moving the partnership's operating assets into a REIT subsidiary. This quarter we have taken additional steps to position the partnership for such an internalization, including first of all, shifting the investment strategy to a direct acquisition development model versus the previous dropdown portfolio acquisition model, driving more accretion with higher cap rate acquisitions and developments.

Secondly, reducing financial leverage levels to provide more operational flexibility and more closely resemble the balance sheets of REIT peers. Third, providing performance metrics that are common to REITs, including FFO and AFFO per unit. And lastly maintaining the existing quarterly distribution of $0.3675 per common unit, in order to retain operating cash flow in the near term to fund higher organic growth including acquisition and development activities. We believe that the strategic move to become an internally managed REIT will benefit the partnership unitholders in many ways, including having full access to sponsor's acquisition development pipeline.

Turning to our Q3 results, the formation of the joint venture on September 24 with Brookfield had a significant impact on our results for the quarter and the presentation of our financial information. As part of the initial transaction with Brookfield, we contributed a portfolio of assets and associated liabilities to jointly controlled venture and recognize the gain on the transaction of $100 million. As we have outlined in the past and with our new direct acquisition model, we are able to invest in individual assets at prices substantially lower than the portfolio valuation of these assets. We expect to be able to reinvest these net proceeds at substantially higher cap rates through our direct acquisitions and development activity. Looking forward, we will be accounting for the joint venture as an equity method investment rather than as a consolidated subsidiary. As part of that presentation, our reported revenue and expenses will only include the properties in our consolidated subsidiaries. And we will report the earnings from the joint venture as equity income from unconsolidated joint ventures.

As part of this as part of these -- as part of this presentation, our metrics such as occupancy and property count will only include the consolidated properties. Turning back to our third quarter results, our portfolio continues to perform well with strong occupancy rates and revenue growth. Rental revenue in the third quarter increased by 5% over the second quarter and 30% year-over-year, driven by the acquisition activity as well as contractual rent escalators and lease modifications and renewals. We continue to target higher cap rate assets that are more accretive, with the average cap rate for acquisitions year-to-date as of September 30, 2018, north of 7.5%. As I noted earlier, directly acquiring assets allows us to acquire assets at higher cap rates compared to larger portfolios. We anticipate acquisitions to remain at similar cap rates or higher for the remainder of 2018 and into 2019. As I outlined previously, we've added new disclosures in our press release, principally FFO and AFFO in an effort to increase comparability of our results with our REIT peers and provide more transparency in our results.

FFO per unit was $0.29 this quarter, compared to $0.24 in the third quarter of last year. AFFO per diluted unit was $0.34 this quarter, compared to $0.32 in the third quarter of last year. Adjusted EBITA, which excludes several non-cash items including gain on sale of real property interests, unrealized gain on derivatives and acquisition-related expenses increased to $17.3 million for the third quarter, an increase of 30% year-over-year. The increase in AFFO and adjusted EBITDA was principally due to the acquisitions we have completed over the course of 2017 and 2018, as well as organic growth generated from the portfolio.

Turning to our balance sheet, we finished the quarter with $140.5 million of outstanding borrowings under our revolving credit facility and secured notes from our securitizations were approximately $226 million at the end of the quarter. The large sequential decline in our debt balances was principally due to the Brookfield transaction in September 2018. With that transaction, we have significantly de-levered the balance sheet with the total partnership debt to adjusted EBITDA at approximately 6.5x as of September 30, 2018. As we announced earlier this week, we are in the process of refinancing our revolving credit facility, that is set to mature in November 2019. As of today, we have received initial commitments of the new five-year revolving credit facility of over $450 million. We expect terms of the new facility to be improved from the existing facility with lower spreads over LIBOR and lower non-use fees. We also expect the facility to include borrowings in non-US dollar currencies. The transaction is anticipated to close in the fourth quarter.

Regarding our 2018 guidance, with the joint venture transaction completed and our revised operating model going forward, we are updating our guidance. Looking forward, we expect acquisitions to be almost entirely direct acquisitions that will drive higher accretion. We also anticipate development activities to represent a substantial portion of our investment opportunities. As we have outlined in our call today, we have made substantial progress on our development initiatives with the anticipated spend picking up in the fourth quarter and 2019. As these developments are expected to be more accretive than direct acquisitions, we are focusing our near-term capital deployment towards these projects and reducing our focus on direct acquisitions. Given our plan for the remainder of the year, we are setting our 2018 acquisition guidance at $175 million, including $35 million in development spending.

Additionally, given the significant development acquisition opportunities in our pipeline, we intend to maintain the quarterly distribution of $0.3675 per common unit in order to retain capital to fund these developments and drive higher organic growth. The decrease in the amount of development spending in our updated guidance is a function of the timing of the developments. However, the development pipeline heading into 2019 is greater than what we were previously reflecting in our guidance. Lastly, as it relates to our coverage ratio, during the quarter, our coverage ratio improved over Q2 as expected. As we have discussed on the call today, ,we have substantial dry powder for acquisition and development activities. As we execute on the acquisition development activities we have discussed today, we expect our coverage ratio to substantially improve and support further distribution increases.

Although we have made substantial progress on our development activities, we do not anticipate the assets being placed into service and generating meaningful revenue until the first part of 2019. As we head into the fourth quarter of 2019, we expect the recent JV formation with Brookfield, and line of credit refinance to collectively have a negligible impact on our AFFO and distributable cash flow, but position us well for executing on our strategic initiatives. We are excited about the prospects for our business given the attractive acquisition and development opportunities we are seeing and the macro trends in the telecom industry.

We will now take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from Bora Lee with RBC Capital Markets.

Bora Lee - *RBC Capital Markets, LLC, Research Division - Associate VP*

I was just wondering, you referenced this a little bit, but what sort of organizational structure process or IT changes need to be made in preparation for the corporate structure being considered? And can you talk to any milestones we should be watching out for?

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Sure. Because we already operate as a REIT in the subsidiary that owns the majority of the assets. We don't have to really make a lot of changes in the organization or systems that were part of the benefit of doing that conversion back in 2017. So for the most part, we are ready to operate as an internally managed REIT with a few, I would say minor tweaks to some of the processes and organizational structure. I think the milestone to really focus on is the revenue growth of the partnership. We need the revenue or call it EBITDA to be roughly in the $150 million to $250 million range before we'll have an opportunity to do that internalization.

So, we must we -- or I should say the $150 million is kind of the minimum number that we would need in order to be able to absorb additional G&A and then run as an internally managed REIT.

Bora Lee - *RBC Capital Markets, LLC, Research Division - Associate VP*

Understood. Thank you.

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Sure.

Operator

Our next question comes from Liam Burke with B. Riley FBR.

Liam Dalton Burke - *FBR Capital Markets & Co., Research Division - Former Analyst*

Tim, on the DART project, you mentioned the scalability within the actual network, can this be used as a blueprint or a reference account to go to similar municipalities to offer that type of application?

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Can be and that's exactly what we've been looking at, and talking about since we started developing the different programs for these different types of real estate partners. This is a -- it's a template that we'll use for new business development opportunities. The FlexGrid product was actually featured at Mobile World Congress Americas, we got a lot of traffic there as a lot of discussions with various real estate owners to see the benefit and see how this could be a significant part of their smart city initiatives, and we'll be able to customize that depending on the preferences and objectives of all these different real estate partners. So, it turns out to be incredibly flexible from that perspective.

Liam Dalton Burke - *FBR Capital Markets & Co., Research Division - Former Analyst*

What would you expect since the business model is shifting a little bit in terms of development? What it would be a normal cell cycle or development cycle on one of these types of projects -- one larger projects would be?

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Sure. I would say the larger projects are in the 12 to 18 month range. And that is partly the reason we've shifted a little bit on the timing of some of our development expenditures. Lining up these projects and getting the contracts in place does tend to take a bit of time, but we do have a lot of different opportunities that we've been working on over the course of the last couple of years, and it's great to see, some of them starting to come to fruition here.

Operator

Our next question comes from Ric Prentiss with Raymond James.

Jayson Tyler Bedford - *Raymond James & Associates, Inc., Research Division - Senior Medical Supplies and Devices Analyst*

This is Jason for Ric. As you guys move to I guess a direct acquisition, I understand -- how you seeing the competitive environment for the assets and what type of cap rates are you guys looked at as you move to the direct acquisition?

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Sure. The competitive environment for telecom, I would say it's been pretty consistent over the last two, three years, you have the major tower companies and some other groups that we see on occasion that compete with us for assets. But we certainly are able to acquire a significant amount at the targeted cap rates that we're looking to invest that in. It depends on the structure of the asset and the level of competition, but we see acquisition opportunities in the probably 6 to 8 cap range, and we're focused on acquiring the assets in that 7 to 8 cap range is where I expect us to be investing in over the next couple of years.

Operator

Thank you. Our next question comes from Mike Gyure with Janney.

Michael Christopher Gyure - *Janney Montgomery Scott LLC, Research Division - MD of Forensic Accounting and MLPs*

Could you talk a little bit, the joint venture with Brookfield? I guess if you envision that being kind of a one-off deal or kind of the start of a relationship where you would do sort of other assets? And then if it is sort of the potential to do other assets, I guess how do you characterize, what would go to the JV versus what will go the REIT or the MLP?

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

So the initial portfolio that we contributed to the partnership. It was a great opportunity for us, given the stage of, I would say, acquisition development opportunities, and given our -- given the attractive cost of capital, made a lot of sense to start out with this initial portfolio that we contributed.

Going forward, we're going to look at different opportunities and depending on what makes sense from a cost to a capital standpoint and where it makes sense to bring in a larger capital partner, we'll consider bringing in the joint venture capital to acquire or invest in those assets. It's our decision as to what type of opportunities get presented to the JV for acquisition. There's certainly no commitment on behalf of Brookfield to invest further. But the idea of the formation of venture versus just an outright sale of the assets is to potentially have that opportunity to continue to invest in portfolios or different types of assets.

Michael Christopher Gyure - *Janney Montgomery Scott LLC, Research Division - MD of Forensic Accounting and MLPs*

Okay. And then on the strategy that direct acquisition and development model. I guess how should we think about personnel costs within the MLP or the REIT as we move into early '19? It sounds like we're still not in the process of ramping up and adding people within the REIT or the MLP, but can you talk a little bit about that? And I guess you didn't talk a little bit about the timing?

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Sure. And this is where the sponsor's support really comes into play here because the sponsor is the one that's lining up all of the acquisition and development opportunities and to-date on the direct acquisitions and developments, there's been no reimbursement to the sponsor for any of the overhead it's incurring to drive these opportunities. So, it's a very advantageous relationship for the public partnership.

There is no other way to invest in these types of acquisitions and developments without incurring that sponsor overhead. So, we expect to see that continue for the foreseeable future, which is great because we're able to acquire assets at substantially say below market valuations, which is a real advantage for the partnership.

Operator

(Operator Instructions) Our next question comes from Jennifer Fritzsche with Wells Fargo.

Jennifer Murtaugh Fritzsche - *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

I apologize if this came up, but there seems to be some tower companies looking at call alternative business models, such as the microedge data centers (inaudible) is this something that you're having conversations about or is it -- given your ownership of the land, is that something you could participate in, it's clearly early days, but just wondering in that?

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Sure, absolutely, we've given that some consideration and when you think about the tower sites, rooftop sites, they have some of the infrastructure that you would need for data center or potentially other type of infrastructure that could be located at those sites. So, far what we've seen is, it's really early stage, we haven't seen a proven business model on that front. But it's something that we're still monitoring and if it becomes a significant opportunity for investment in driving higher returns then we will likely be pursuing it.

Operator

Thank you. I'm not showing any further questions in queue. So I'd like to turn it back over to -- I see no further questions in queue, I'd like to turn back over to management for closing remarks.

Arthur P. Brazy - *Landmark Infrastructure Partners LP - CEO & Director of Landmark Infrastructure Partners GP LLC*

Great, thank you very much and thank you all for joining us today. As George and I've said, we're excited about the opportunities we have in front of us, we are confident in our ability to deliver continued growth at the partnership. And we look forward to sharing more information with you as we move forward. We'll speak to you next quarter.

Operator

Thank you. And ladies and gentlemen, this does conclude today's conference. Thank you very much for your participation. You may all disconnect. Have a wonderful day.
